

Tax Notes Today

November 20, 2014

IRSAC SAYS IRS NEEDS MORE FUNDS, SEVERAL REFORMS

By William Hoffman

While the Internal Revenue Service Advisory Council presented the agency with recommendations for dealing with new marijuana businesses, growing concern over increased business identity thefts, and automated underreporter customer satisfaction, most council members agreed on November 19 that the most pressing issue is the same one Commissioner John Koskinen pleads in almost every public appearance -- more funding from Congress.

"If I had to choose one issue that stood out, it would be the budget," incoming IRSAC Chair Fred Murray told Tax Analysts after the council's annual meeting. "It's the one issue that affects all the others."

The simultaneously released IRSAC annual report (Doc 2014-27491) made the IRS's need for "sufficient" funding -- defined as no lower than the \$ 12.5 billion requested by the administration for fiscal 2015 -- its top issue, arguing that not only does the agency's budget squeeze endanger its missions to provide effective service and enforcement in the short term, but that "the IRS is in the midst of an existential funding crisis." Continued underfunding could result in reduced revenue to the federal Treasury, lack of service personnel with the necessary experience, declining quality of service, and erosion of the voluntary compliance regime, the report said.

Beyond the need for more money, the four IRSAC subgroups presented their findings and recommendations to a panel of IRS operating division executives.

Circular 230 'Under Siege'

Karen Hawkins, director of the IRS Office of Professional Responsibility, said, "This has been one of the more challenging years that OPR and Circular 230 . . . has had, not just with litigation that has been decided but with litigation that we know is still pending."

"Anybody who is relaxed about the status of [Circular] 230 needs to kind of get a wake-up call," Hawkins added. "It's under siege." (Prior coverage (Doc 2014-25905).)

Hawkins said she is concerned about the pattern represented by cases such as *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014) (Doc 2014-3158), which held that the agency has no statutory authority to regulate paid tax return preparers, and *Ridgely v. Lew*, No. 1:12-cv-00565 (D.D.C. 2014), which held that a CPA who only prepared tax returns was not acting in a representative capacity for a taxpayer.

Those cases, Hawkins said, "have been preemptive strikes under the Administrative Procedures Act in front of judges -- with no disrespect intended -- who have a very short-sighted view both of the relationship between the title 31 statute, under which we all function, versus the title 26 function for the IRS, and the need for the maintenance of integrity within the tax system by having ethical rules to enforce, and particularly to have ethical rules about people before they do bad things as representatives, which is really I think the piece that has been missing."

The IRSAC report highlighted questions about the extent to which the Service can regulate any tax return preparer who is not acting as a taxpayer's representative. The council recommended that Congress grant the IRS statutory authority to regulate return preparers.

Guidance for Pot Businesses

OPR also received suggestions for the IRS in dealing with the many marijuana businesses that have sprung up in the wake of legalization in Colorado and Washington state, and that are expected to proliferate now that marijuana has been declared legal by plebiscite in Oregon and Washington, D.C.

While pot has been declared legal in several states and jurisdictions, it remains illegal under federal law. IRC section 280E does not allow federal tax deductions or credits for marijuana businesses. (Prior coverage (Doc 2014-23102).)

The IRSAC report suggested that the IRS provide guidance that a tax professional will not be considered unethical, will not be targeted for audit, and will not be in violation of Circular 230 solely for representing or preparing a return for a business that is illegal under federal law but legal under state law.

Risk Analysis for Large Business Audits

IRSAC's Large Business and International subgroup recommended that the agency use risk assessments to select taxpayers for audits in order to conserve IRS resources, reduce burdens, and increase certainty.

LB&I subgroup member Timothy McCormally said changes in corporate governance, enhanced transparency requirements in tax law and public accounting rules, "exponential growth" in passthrough entities that are not corporations, and the shrinking IRS budget have made it necessary for the Service to determine "how and why we examine what we examine." (Prior analysis (Doc 2014-8050).)

Risk analysis can be done more efficiently, the IRSAC report said, by reviewing publicly available data on the taxpayer, such as a revised Schedule UTP (uncertain tax position), and "expanding its centralized approach to analyzing the compliance risk associated with large corporations."

IRSAC recommended an expansion of and building upon what's already established under Schedule UTP and an expansion of the community of taxpayers who can file that form. "Revisions to the schedule should focus on the existence and support for the company's tax control framework, and should be framed as yes-or-no questions," the report said.

The LB&I subgroup also advised that the Service do a better job educating and informing taxpayers when an IRS examination team uses internal functional, technical, and issue experts about who "owns" an issue when these experts are involved.

Business ID Theft Growing

IRSAC member Cheri Freeh, reporting for the Small Business/Self-Employed subgroup, noted that not only corporations, partnerships, trusts, and estates, but government entities and nonprofit organizations can be victims of the growing trend of business identity theft.

"The refunds that can be generated on business returns can be substantially larger than individual refunds, which is probably one of the reasons that this is becoming a little more popular with the thieves," she said.

Business identity theft cases also tend to be more complicated, "so layered in different functional areas of the IRS, and they're so difficult to detect, and they're even more difficult for the IRS and personnel to work out," Freeh said. One problem is that businesses' employer identification numbers are not only printed on each individual employee's Form W-2, but are sent to every vendor, investor, individual, or business to whom the taxpaying entity issues a Form 1099.

"While Social Security numbers receive some level of protection, there is no protection for business identification numbers," the IRSAC report said.

The SB/SE subgroup recommended expansion of REG-148873-09 (Doc 2013-114) truncation guidance to include truncated EINs of issuers on any copies of IRS filings provided to outside parties or made public, or to any forms not submitted to the IRS. The Service should also develop and implement procedures whereby a taxpayer must surrender an EIN no longer in use because the business is closed or no longer in service.

Improve Automated Underreporting

The IRSAC's Wage and Investment (W&I) subgroup examined changing the behavior of taxpayers who prepare their returns electronically but file them on paper, improving Compliance Services Collection Operations customer satisfaction, and improving automated underreporter customer satisfaction.

The IRS Wage and Investment Division "probably touches more taxpayers than any other function, any other division," said W&I subgroup Chair Andre' Re. The underreporter program "is the most productive program the IRS has. Dollar for hour, it actually beats [LB&I's] large case" program, he said.

Automated underreporting results could be improved by applying statistical process analysis procedures to identify areas for improvement, Re said. The IRSAC report recommended minimizing uncontrolled correspondence and periodically adjusting the default timeline to consider uncontrolled mail receipt delays, as well as offering an online tool similar to the "Where's My Refund?" tool to show the status of a taxpayer's case.